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In the

SUPREME COURT OF THE UNITED STATES

October term, 1970

No. 1422

GILBERT SHAW and GLORIA E. SHAW

Petitioner

v.

UNITED STATES OF AMERICA

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Gilbert Shaw and Gloria E. Shaw, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above case on December 3, 1970 enforcing an order of the United States District Court for the District of Vermont issued April 15, 1970.

OPINIONS BELOW

The judgment of the United States Court of Appeals for the Second Circuit is reprinted in Appendix B. It is not generally reported.

The OPINION AND ORDER of the United States District Court for the District of Vermont is reported in Appendix C. It is not generally reported.

JURISDICTION

The judgment of the United States Court of Appeals in the Second Circuit was entered on December 3, 1970. The jurisdiction of this court is evoked under Title 28 United States Code Section 1254.

QUESTIONS

1. Was the OPINION AND ORDER of the United States Court for the District of Vermont in error in granting the United States' MOTION TO DISMISS with respect to the ground that the District Court lacked jurisdiction over the person of the defendant, because of its sovereign immunity when plaintiff relied upon Title 28 United States Code Section 2410(a)(1) and Title 28 United States Code Section 1346 (a)(1) for specific federal jurisdiction and where

a) The District Court did not determine whether plaintiff's reliance upon Title 28 United States Code Section 2410(a)(1) placed plaintiff's Civil Action 5617 within the three-fold purpose of SEction 2410(a)(1) stated in the District Court's OPINION AND ORDER.

b) The District Court could not have established whether defendant's reliance on Title 26, Internal Revenue Code of 1954, Section 7421(a) was correct as opposed to plaintiff's reliance upon Title 28, United States Code, Section 1346(a)(1) without

making a determination as to whether under no circumstances could the Government ultimately prevail.

2. Could the United States' MOTION TO DISMISS have been granted on the alternate theory that plaintiff's complaint failed to stated a claim upon which relief could be granted when the District Court admitted a MEMORANDUM OF THE DEFENDANT IN SUPPORT OF MOTION TO DISMISS which covered matters outside the pleadings; such action requiring that defendant's MOTION TO DISMISS be treated as a MOTION FOR SUMMARY JUDGMENT as required by Federal Rules of Civil Procedure 12(b) and 56.

STATUTES INVOLVED (APPENDIX A)

Title 28, U.S.C.A. page 340 Section 2410(a)(1).
Title 28, U.S.C.A. page 251 Section 1346(a)(1).
Title 26, Internal Revenue Code of 1954, page 369, Section 7421(a).
Title 26, Internal Revenue Code of 1954, page 241, Section 1235.
Title 26, Internal Revenue Code of 1954, page 317, Section 1311(b)(1).

STATEMENT OF THE CASE

Petitioner, Gilbert Shaw and Gloria E. Shaw, have regularly declared and paid their income tax on a joint basis. That part of their income in controversy at this time involves 'sale of foreign patents' income reported uniformly as Section 1235 Internal Revenue Code of 1954, Title 26 and the precedent setting and improper change to ordinary income made for this income by the Appellate Division for the tax year 1964.

Petitioner, not legally trained, is acting pro

se in this case because the amount involved in the controversy is in the twilight zone where legal fees could soon offset the amount in issue.

On June 30, 1969 Petitioner filed a Complaint in Civil Action 5617 in the United States District Court for the District of Vermont.

Respondent moved the Court on August 20, 1969 pursuant to Rule 12(b)(2) and (6) of the Federal Rules of Civil Procedure to dismiss the action on the grounds that the Court lacked jurisdiction over the person of the defendant, because of its sovereign immunity from suit, and the complaint fails to state a claim upon which relief can be granted.

Respondent at the same time filed a MEMORANDUM FOR THE DEFENDANT IN SUPPORT OF MOTION TO DISMISS which was not excluded by the Court and which contained matters outside the pleadings. At that time, plaintiff's Complaint was the only pleading in being.

In the petitioner's Complaint, petitioner made a short and plain statement for the basis of jurisdiction of the Federal Court.(Complaint 4, pages 4a-5a*) Subsequently, in AFFIDAVIT IN OPPOSITION TO DEFENDANTS MOTION TO DISMISS (p28a-30a) under the heading JURISDICTION, the basis for jurisdiction was more specifically invoked with respect to Title 28, U.S.C. Sections 2410 (a)(1) and 1346(a)(1). Jurisdiction was further invoked for these reasons on page 113(a), page 118(a), and at the CONTINUED HEARING ON GOVERNMENTS MOTION TO DISMISS of March 23, 1970 (page 162a).

*Appendix submitted under F.R.A.P. Rule 30(a).

At no time did the District Court entertain discussion of petitioner's federal rights under the following sections of Title 28, U.S.C., 2410(a)(1) and 1346(a)(1), to the end of overcoming the Government's claim of sovereign immunity.

In claim 5, p. 5a, petitioner claimed that the government was trying to collect a sum in the guise of a tax and not as a tax. This claim was not considered by the Government or the District Court.

Nor did the Government or the District Court concede or deny that, as claimed in claim 6, p. 5a, no change in law or fact justified the change in treatment of petitioner's royalty income tax rate in 1964. Petitioner claimed (claim 7, p. 5a) that the United States had acted inconsistently and therefore erroneously and illegally in violation of Title 28, Internal Revenue Code of 1954, Section 1311(b)(1) (page 14a).

No motion of any kind was made by petitioner (p. 132(a)).

Because the Government would not or could not state its position in this controversy, petitioner 's AFFIDAVIT SUSTAINING PLAINTIFF'S ELECTION THAT THE DISTRICT COURT WAS ITS PROPER FORUM (p. 37a), claimed that its only remedy was adjudication of Civil Action 5617 in the Federal Court.

Hearings were held on January 28, 1970, March 2, 1970, and March 23, 1970. None of these hearings went to the merits of the case.

The Government's MOTION TO DISMISS was granted on April 15, 1970.

REASONS FOR GRANTING THE WRIT

This case presents important questions of federal law pertaining to specific statutory grants of jurisdiction that pierce the defense of sovereign immunity of the United States.

Bell v. Hood (1946) 327 U.S.678, 66 S.Ct. 773, 90 L ed 939 states:

> The claimant (in this case, Gilbert Shaw and Gloria E. Shaw) is master of his action to the extent he may decide what law he will rely upon and the oourt must look to the way his claim is is pleaded to see if a substantial federal question is there presented.

Bell v. Hood also states:

> If he (petitioner) decides to rely on Federal law and his claim based on that law is not frivolous or sham but a right or immunity created by the Constitution or laws of the United States appears as an essential element in an orderly statement, then jurisdiction is well founded and judgment for or against the plaintiff should be on the merits.

QUESTION 1, page 3, names the laws of the United States upon which petitioner bases his claim. They are Title 28, U.S.C. Sections 2410(a)(1) and 1346 (a)(1).

Under Title 28, U.S.C. Section 2410(a)(1) Bell v. Hood obligated the District Court to test petitioner's reliance on 2410(a)(1) against the three purposes for which Section 2410(a)(1) was intended.

Exhibit 3 of the petitioner's reply brief shows clearly that a bank account jointly owned by Gay

Miller, not a party in this case, and Gloria E. Shaw, was levied for a lien imposed following a deficiency notice in this controversy. Surely this error fell within the purpose of Title 28, U.S.C., Section 2410(a)(1).

Perhaps of greater importance is the part that Title 28, U.S.C., Sections 1346(a)(1) plays in this controversy.

Of Section 1346(a)(1) Walter W. Flora, Petitioner v. United States of America paragraph 2 continued page 637, states:

> .....the function of the phrase 'any sum' is to permit any suit for recovery of items which might not be designated as either taxes or penalties by Congress of the courts. 28 U.S. C.A. Section 1346(a)(1).

On this point 28 U.S.C.A. 1346 (a)(1) states

> Section 1346 United States as a defendant
> (a) The district courts shall have original jurisdiction, concurrent with the Court of Claims, of:
> (b) ..... any sum alleged to have been excessive or in any manner wrongfully collected under the internal revenue laws;

The word "excessive" controls in this case, and the proper yardsticks lie in Section 1235 and 1311 (b)(1) of the Internal Revenue Act of 1954.

Section 1235 applied to petititioner's foreign royalty income from 1958 to 1963. It also should have applied in 1964 and thereafter. From 1958

(see F. R. Mortenson's "Patent Royalties, Capital Gains or Ordinary Income" - Appendix D) to E. I. DuPont de Nemours V. United States (D.C. Del, 1969) 23 AFTR 2nd 69 - 727, 296 F. Supp. 823) and even today the criterion for capital gains remains:

> ....a transfer of all the substantial rights in a patent is deemed an assignment and qualifies transferor for capital gains treatment. A transfer of anything less is called a license with a resultant assessment of the tax at ordinary income rates.

No law or fact has been claimed by the Government to alter the concept that since 1958 petitioner's actions were anything else than a transfer or a sale. (See Appendices E and F)

Defendant and the Court have placed great weight on Title 26 Internal Revenue Code Section 7 421(a) but have failed to recognize exceptions to 7 421(a) such as Enochs v. Williams Packing Co. 370 U. S. 1 (1962) and Miller v. Nut Margarine Co. 284 U.S. 498 which state respectively:

Enochs v. Williams Packing Co.; p. 7:

> The manifest purpose of Section 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund. In this manner the United States is assured of prompt collection of its lawful revenue. Nevertheless, if it is clear that under no circumstances could the Government ultimately prevail, the central purpose of the Act is applicable and, under the Nut Margarine case, the attempted collection may be enjoined if equity jurisdiction otherwise exists. In such a situation the

> exaction is merely in "the guise of a tax." Id., at 509.
>
> We believe that the question of whether the Government has a chance of ultimately prevailing is to be determined on the basis of the information available to it at the time of suit. Only if it is then apparent that, under the most liberal view of the law and the facts, the United States cannot establish its claim, may the suit for an injunction be maintained.

Miller v. Nut Margarine Co., p. 511;

> It is clear that, by reason of the special and extraordinary facts and circumstances, Section 3224 [Now Title 26, Section 7421 (a) of the Internal Revenue Code of 1954] does not apply. The lower courts rightly held respondent entitled to the injunction.

However, Section 1311(b)(1) of the Internal Revenue Code of 1954 prohibits assessment and levy against a taxpayer who has maintained a consistent position, and there has been no change in law or fact in his case.

CONCLUSIONS

For the reasons stated, this petition for a writ of certiorari should be granted.

Respectfully submitted

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APPENDIX A

Title 28, U.S.C.A. page 340 Section 2410(a)(1).
Actions affecting property on which United States has lien

(a) Under the conditions prescribed in this section 1444 of this title for the protection of the United States, the United States may be named a party in any civil action or suit in any district court, or in any State court having jurisdiction of the subject matter--

(1) to quiet title to
. . .
. . .
. . .

. . .

real or personal property on which the United States has or claims a mortgage or other lien.

Title 28, U.S.C.A. page 251 SEction 1346(a)(1).
United States as defendant

(a) The district courts shall have original jurisdiction, concurrent with the Court of Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws;

Code Sec. 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) Tax. Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a), no suit for the purpose of restraining the assissment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

Code Sec. 1235. SALE OR EXCHANGE OF PATENTS.

(a) General.--A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are--

(1) payable periodically over a period generally coterminino us with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the orpperty transferred.

Code Sec. 1311. CORRECTION OF ERROR.

(b) Conditions Necessary for Adjustments.--

(1) Maintenance of an inconsistent position.-- Except in cases described in paragraphs (3(B) and (4) of section 1312, an adjustment shall be made under this part only if--

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his

delegate or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made.

and the position maintained by the Secretary or his delagate in the case described in subparagraph (a) or maintained by the taxpayer in the case described in subparagraph (b) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

APPENDIX B

Case No. 35155

GILBERT SHAW and GLORIA E. SHAW
Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the third day of December one thousand nine hundred and seventy.

Present: Endorsed:
HON. HENRY J. FRIENDLY,
HON. J. JOSEPH SMITH,
HON. ROBERT P. ANDERSON,
Circuit Judges

Appeal from the United States District Court for the District of Vermont.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Vermont, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed with costs to be taxed against the appellants.

A. DANIEL FUSARO
Clerk

APPENDIX C

OPINION AND ORDER

In the

UNITED STATES DISTRICT COURT

For the District of Vermont

[SAME TITLE]

Gilbert Shaw and Gloria E. Shaw, plaintiffs, pro se.

Norman Cohen, Assistant United States Attorney, Rutland, Vermont, for defendant.

LEDDY, Chief Judge.

On June 30, 1969, the plaintiffs, pro se, filed a civil action in this Court against the United States entitled: To Quiet Title to Plaintiffs Property by Removing Treasury Department Tax Lien. In the complaint, the plaintiffs asked to have the cloud on their title to property removed by invalidating a tax lien, and for injunctive relief restraining the Government from collecting the specific tax in issue. It appears from the complaint that for a period of time (1958-1963), the plaintiffs had certain foreign royalty income treated as capital gains. However, it is alleged that in 1964 and thereafter, this same income was classified as ordinary income which thereby denied the plaintiffs the more favorable tax treatment. According to the complaint, there is not basis in law or fact for this subsequent change in treatment by the Internal Revenue Service. On August 21, 1969, the defendant filed a motion to dismiss on the ground that this Court lacks jurisdiction over the person of the defendant because of sovereign immunity and on the alternate theory that

the complaint fails to state a claim upon which relief can be granted.

Hearing was held on March 23, 1970, and memoranda submitted.

Starting with the premise that the United States is immune from suit unless it has specifically consented thereto, Dalehite v. United States, 346 U.S. 15, 30 (1953); United States v. Shaw, 309 U.S. 495, 500-01 (1940), the issue becomes whether in this type of federal tax case there has been a consent. At first blush, 28 U.S.C.A. Section 2410(a)(1965) seems to waive immunity and to allow the plaintiffs to pursue their action in this Court. That section reads:

> Under the conditions prescribed in this section and section 1444 of this title for the protection of the United States, the United States may be named a party in any civil action or suit in any district court, or in any state court having jurisdiction of the subject matter, to quiet title to or for the foreclosure of a martgage or other lien upon real or personal property on which the United States has or claims a mortgage or other lien.

In Falik v. United States, 343 F.2d 38 (2d Cir. 1965), a taxpayer brought an action in the Federal District Court to remove a tax lien of the United States as a cloud on her property. The lien was assessed because of delinquent withholding and social security taxes due from a corporation of which the plaintiff was a responsible officer. The United States moved to dismiss the action on the grounds of sovereign immunity and because of the bar against declaratory judgment tax relief.

The Circuit Court first concluded that the

District Court had subject matter jurisdiction under 28 U.S.C.A. Section 1340 (1962).

But then the Court Stated;

> However, 28 U.S.C. section 1340 alone would not enable the plaintiff to surmount the bars created by sovereign immunity and by the historical prohibition against injunctions or declaratory relief in Federal tax matters.

343F.2d at 40.

The Court then had to decide if section 2410(a) was a waiver by the United States of its immunity. The Court goes on to say:

> ". . . We are persuaded that the present action is not one contemplated by 28 U.S.C. Section 2410(a) *and cannot be entertained on any other* ground.

343F.2d at 40.

Upon consideration of its history and purpose, Judge Friendly concluded that Section 2410(a) was enacted for a three-fold purpose: (1) Permitting joinder when the lien of the United States was junior to that foreclosed, (2) permitting inquiry by a junior lienor into procedural irregularities of the United States Lien, but not the underlying assessment itself, and (3) permitting discharge of United States liens that had been eliminated but not yet cancelled. SEction 2410(a) did not intend to change the traditional rule of "pay first and litigate later" set forth in Flora V. United States, 362 U.S. 145, 164 (1960).

Nor does this Court have jurisdiction to issue any injunction which the plaintiffs may request since the plaintiffs have an adequate remedy at

law by paying the tax and suing for a refund in this Court. Enochs v. Williams Packing & Nevigation Co. 370 U.S. 1(1961); 26 U.S.C.A. Section 7421(a)(1967). Furthermore, this action is directed at the United States and an action to enjoin would have to be brought personally against the District Director since the United States has not consented. 343F2d at 43.

Based on the foregoing reasons, the Government's motion to dismiss is hereby granted.

Done at Burlington in the District of Vermont, this 15th day of April, 1970.

BERNARD J. LEDDY
Chief Judge

Endorsed: Filed April 15, 1970
EDWARD J. TRUDELL
Clerk.

APPENDIX D

PATENT ROYALTIES
CAPITAL GAIN OR ORDINARY INCOME

The most-cited case in this area is Edward C. Myers (CCH Dec. 14,992, 6TC 258). The tax Court there held that an inventor may receive capital gains benefits from the sale of his patent rights, despite the fact that he is paid a royalty from the proceeds resulting from the sales of the patented product. The further history of the problem, culminating in the enactment of SEction 1235, is set forth in Rollman v. Commissioner. (57-1 USTC P 9677,244 F.(2d) 634 (CA-4). The Court there said:

'In Commissioner v. Hopkinson, 2 Cir., 126 Fed. (2d) 406, it was expressly held that the transfer of full and complete title to patent rights constituted a sale of capital assets although the contract provided for installment payments of the purchase price based upon a percentage of the manufactured units; and this view was held by the Commissioner until 1950, as will appear from Mimeo. 6490, 1950-1 C.B.9. In this ruling the Commissioner acknowledged his prior acquiescence as to royalties received from exclusive license agreements for the taxable years beginning after June 1, 1950.....

'In 1954, Congress rejected this ruling of the Commission by enacting 1235 (a) (1), (2) of the Internal Revenue Code of 1954,...which provided that a transfer of all substantial rights to a patent shall be considered a sale or exchange of a capital asset held for more than six months regardless of whether or not payments in consideration of the transfer are made periodically over a period coterminous with the transferee's use of patent, or contingent upon the productivity, use or disposi-

tion of the property transferred.

'In 1955, the Commissioner issued a ruling, Rev. Rul. 55-58, 1955-1 C. B. 97, interpreting this statute to apply only to payments received in 1954 and subsequent years but not to apply to amounts received in taxable years beginning after May 31, 1950 and before January 1, 1954, and accordingly announced that payments received by inventors for the taxable years after May 31, 1950, would be regarded as ordinary income....

'In response to this ruling of the Commissioner, Congress in 1956 enacted 117(q) of the Internal Revenue Code of 1939... in substantially the same terms as the Act of 1954 and provided that the statute should be applicable to any payment made pursuant to a transfer of patent rights in any taxable year beginning after May 31, 1950, regardless of the year in which the transfer occurred.'

The foregoing is taken from an article written by Ernest R. Mortenson, California Attorney, appearing in Commerce Clearing House.
"The Tax Magazine" November 1958.

APPENDIX E

EXCERPT FROM LETTER OF APRIL 23, 1964 to INTERNAL REVENUE SERVICE AGENT WIDELO FROM LIONEL V. LONGHURST, C.P.A. FOR GILBERT SHAW AND GLORIA E. SHAW

'With reference to royalties reported by the above taxpayer as Capital Gains under Section 1235, I would advise you that in going over my files I find that this matter was gone into by Internal Revenue Agent, S. Kremer, at the time of a previous examination and in this connection I am enclosing herewith copies of correspondence with regard thereto. In addition, I am also enclosing an article published in 1958, dealing with this subject. I trust this will help you in your determination."

APPENDIX F

EXCERPT FROM LETTER OF JUNE 26, 1964 FROM INTERNAL REVENUE AGENT WIDELO TO LIONEL V. LONGHURST, C.P.A. FOR GILBERT SHAW AND GLORIA E. SHAW

"I have looked at all the agreements with the foreign countries and am of the opinion that the royalties received by Shaw and Drewes qualifies for capital tax gains in all respects under Section 1235."

APPENDIX G

FEDERAL RULES OF CIVIL PROCEDURE, RULE 12(b)

Rule 12. Defenses and Objections--When and How Presented--By Pleading or Motion--Motion for Judgment on Pleadings.

(b) HOW PRESENTED. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, he may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1422

GILBERT SHAW AND GLORIA E. SHAW, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion and order of the United States District Court for the District of Vermont (Pet. App. 14–17; R. 136–139) [1] and the order of the court of appeals (Pet. App. 13) are not yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered on December 3, 1970. The petition for a writ of certiorari was filed on March 2, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

[1] "R." references are to the record appendix filed in the court of appeals.

420-895—71